
In the United States
Circuit Court of Appeals
For the Ninth Circuit.

Louis M. Grafe,

Petitioner,

vs.

Commissioner of Internal Revenue,

Respondent.

BRIEF FOR PETITIONER.

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No. 7884

In the United States
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Louis M. Grafe,

Petitioner,

vs.

Commissioner of Internal Revenue,

Respondent.

BRIEF FOR PETITIONER.

HISTORY AND PREVIOUS OPINION.

The Commissioner of Internal Revenue, the Respondent herein, on July 8, 1931, mailed to Petitioner a deficiency letter wherein Respondent proposed additional taxes against Petitioner for the year 1929 in the sum of \$12,023.08 [R. pp. 7-10].

Within the sixty day period Petitioner filed his appeal with the United States Board of Tax Appeals, Docket No. 59694 [R. pp. 4, 5, 6, 7], wherein he alleged, among other things: (1) that the Respondent erred in adding to Petitioner's taxable income the sum of \$55,000.00 representing dividends on stock of Paris American Pharmacal

Company that was reported as income on the separate return of Petitioner's wife.

(2) That the Respondent erred in adding to Petitioner's taxable income the sum of \$2,242.50 alleged to represent interest on bonds which was reported as income on the separate income tax return of Petitioner's wife.

(3) That neither the stock, bonds nor dividends and interest thereon were Petitioner's property, therefore, he was not subject to tax thereon [R. pp. 5, 6].

On October 27, 1934, the Board of Tax Appeals promulgated its opinion [R. pp. 12-17] and sustained the Respondent in including both of these sums as taxable income to the Petitioner. The final order of the Board of Tax Appeals was entered on October 29, 1934 [R. pp. 17, 18].

JURISDICTION.

Petitioner resides with his wife at Los Angeles, California, and during the year 1929 was living with his wife at Altadena, California. Each spouse filed separate returns of income for the year 1929 with the Collector of Internal Revenue at Los Angeles, California [R. p. 5].

The memorandum opinion of the Board of Tax Appeals was promulgated October 27, 1934 [R. pp. 12-17].

The final order of the Board was entered October 29, 1934 [R. p. 18].

Petitioner filed his petition for review by this Honorable Court with the Clerk of the United States Board of

Tax Appeals on January 25, 1935 [R. pp. 18-27]. This appeal was taken pursuant to the provisions of Sections 1001, 1002 and 1003 of the Act of Congress approved February 26, 1926, entitled "The Revenue Act of 1926" (44 Stat. 1, 109, 110; U. S. C. A., Sections 1224, 1225, 1226), as amended by Section 603 of the Act of Congress approved May 29, 1928, entitled "The Revenue Act of 1928" (45 Stat. 873), as further amended by Section 1101 of the Act of Congress approved June 6, 1932, entitled "The Revenue Act of 1932" (47 Stat. 286), and as further amended by Section 519 of the Act of Congress approved May 10, 1934, entitled "The Revenue Act of 1934" (48 Stat. 760, 26 U. S. C. A., Section 1225).

QUESTIONS INVOLVED.

(1) Whether the sum of \$55,000.00 representing dividends paid on stock of the Paris American Pharmacial Company, which was reported as taxable income on the separate return of Petitioner's wife, was income to this Petitioner.

(2) Whether the sum of \$2,242.50 representing interest (reported by Petitioner's wife) paid on bonds, was income to this Petitioner.

STATUTES INVOLVED.

Revenue Act of 1926, Section 907 (a) as amended:

"* * * In any proceeding involving the issue whether the petitioner has been guilty of fraud with intent to evade tax, where no hearing has been held

before the enactment of the Revenue Act of 1928, the burden of proof in respect of such issue shall be upon the Commissioner. The mailing by registered mail of any pleading, decision, order, notice, or process in respect of proceedings before the Board shall be held sufficient service of such pleading, decision, order, notice, or process."

Revenue Act of 1928, Section 22 (a):

"General Definition.—'Gross income' includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever."

STATEMENT OF FACTS.

The Petitioner, on July 31, 1928, incorporated the Paris American Pharmacal Company, a mail order business. This corporation was capitalized at \$7,000.00, divided into 70 shares of stock at \$100.00 par value each. Petitioner had no money of his own at the time of incorporation. The money used to incorporate the business was procured from Petitioner's wife, comprising about \$5,000.00 in cash, derived from the sale of a bungalow in St. Louis,

Missouri, which was the separate property of Petitioner's wife, and approximately \$3,400.00 borrowed on insurance policies on Petitioner's life which had previously been assigned to Petitioner's wife. In addition to this money, credit was extended to the corporation by reason of a guarantee made by Petitioner's mother-in-law, Ivey R. Lewis, who signed a note for \$3,400.00, which was given to Schafer-Brennan Advertising Company of Des Moines, Iowa, as security for advertising expenses. Additional credit was extended to the corporation by reason of additional guarantees made by Mrs. Lewis. As security for the note that was given by Mrs. Lewis, 25 shares of the stock were issued to her. The books show that this stock was relinquished to Petitioner's wife on February 3, 1930. At the time Petitioner's wife put up the money to start the business, it was agreed and understood that she was to receive all of the stock of the new corporation except 15 shares, which were retained by Petitioner for his services. It was also agreed that he was to receive 5% on the gross sales made by the company. Upon the advice of counsel, all of the shares of the stock at the time of incorporation, were issued in Petitioner's name. The books of the corporation show that the stock was subsequently split up and re-issued as follows:

| Certif. No. | Issued to | Date | Transfer | | Transfer to Ctfs. |
|----------------|--------------------|---------|------------|---------------|-------------------------|
| | | | No. Shares | from Ctfs. | |
| 1 | Louis M. Grafe | 7-31-28 | 70 | | 2, 3 & 4 |
| 2 | Mrs. Ivy R. Lewis | 1-17-29 | 25 | 1 | 5 |
| 3 | Mrs. Loy Ola Grafe | 1-17-29 | 30 | 1 | 6 |
| 4 | Louis M. Grafe | 1-17-29 | 15 | 1 | 7, 8 & 9 |
| 5 | Mrs. Loy Ola Grafe | 2- 3-30 | 25 | 2 | |

The corporation was a marked success, and in February and March of 1929 two dividends were declared of 500% each. The books of the corporation show that these dividends were paid on the 70 shares of stock of the Paris American Pharmacal Company as follows:

| | | | | |
|---------------------|------------|--|-------------|-------------|
| February 28, 1929, | | | | |
| L. M. Grafe, | \$7,500.00 | | | |
| February 28, 1929, | | | | |
| Mrs. Ivy R. Lewis, | 12,500.00 | | | |
| February 28, 1929, | | | | |
| Mrs. Loy Ola Grafe, | 15,000.00 | | | |
| Total | | | | \$35,000.00 |
| March 15th, | | | | |
| Mrs. Ivy R. Lewis, | 1,902.92 | | | |
| March 15th, | | | | |
| Mrs. Ivy R. Lewis, | 10,597.08 | | | |
| Total | | | \$12,500.00 | |
| March 18th, | | | | |
| Mrs. Loy Ola Grafe, | 15,000.00 | | | |
| March 18th, | | | | |
| L. M. Grafe, | 7,500.00 | | | |
| Total | | | 22,500.00 | |
| | | | | \$35,000.00 |

For the year 1929 Petitioner reported on his return \$15,000.00 as dividends having been received from said

corporation. The dividends paid to Mrs. Lewis and Mrs. Grafe, \$25,000.00 and \$30,000.00, respectively, aggregating \$55,000.00, were reported as income by Petitioner's wife on her separate return of income. During December, 1928, January, February, March, and April of 1929, bonds were purchased and held by Petitioner's wife, being approximately thirty lots of bonds, aggregating a cost of \$53,787.20. The interest received on the bonds during the year 1929 amounted to \$2,242.50, all of which was returned by Petitioner's wife as her separate income. In the sixty day notice of determination, the Respondent has added to Petitioner's income the sum of \$55,000.00 representing dividends and \$2,242.50 representing interest reported by Petitioner's wife, and proposed a deficiency in tax against this Petitioner of \$12,023.08.

About a year and a half after the corporation was organized, it was decided, for business reasons, to move the corporation to the State of California. Because of the stockholders' liability law then in force in California, Petitioner and his wife agreed (on advice of counsel) to transfer all of the stock that belonged to Petitioner's wife back to Petitioner to be held in his name for his wife. On June 6, 1932 (soon after the stockholders' liability act was repealed), the stock was transferred back to Petitioner's wife.

The uncontradicted testimony shows that the transfers of the stock to the wife and mother-in-law on January 17, 1929, were genuine, and for valuable considerations, and that the dividends paid thereon were neither actually nor constructively received by this Petitioner but were the income of Petitioner's wife. A similar state of facts applied to the bonds and the interest received thereon.

ASSIGNMENTS OF ERROR.

Petitioner relies upon the assignments of error set forth in his petition for review, which are as follows:

(1) That the Board erred in holding that the \$55,000.00 in dividends declared and paid on the 55 shares of stock of the Paris American Pharmacal Company held in the name of Loy Ola Grafe (wife) and Ivey R. Lewis (mother-in-law), was income to this Petitioner.

(2) That the Board erred in adding to Petitioner's taxable income the sum of \$2,242.50 representing interest on bonds owned and held by Petitioner's wife.

(3) That the Board erred in failing to find as a fact and concluding that Petitioner was not the owner of the 55 shares of stock of the Paris American Pharmacal Company nor the \$55,000.00 in dividends paid thereon to Petitioner's wife and mother-in-law during the months of February and March of 1929.

(4) That the Board erred in failing to find as a fact and concluding that the Petitioner was not the owner of the various and sundry bonds or the interest earned thereon of \$2,242.50 held by Petitioner's wife.

(5) That the Board erred in finding as a fact and concluding that the transfer of the aforementioned 55 shares of stock of the Paris American Pharmacal Company to Petitioner's wife was lacking in bona fides and that the Petitioner failed to bear the burden of proof.

(6) That the Board erred in failing to find from the uncontradicted testimony that the money with which the Paris American Pharmacal Company was organized and started business belonged to and was the separate property of Petitioner's wife and that the 55 shares of stock issued to Petitioner's wife and his mother-in-law on January 17, 1929 were in fact payment for the money thus advanced for organizing and starting said business and were the separate property of Petitioner's wife.

(7) That the Board erred in arbitrarily discrediting the testimony of a non-impeached taxpayer so far as he testified to facts.

(8) That the Board erred in its conclusion of law and the application of law to the facts.

(9) That the Board erred in that the decision, memorandum opinion, and order of the Board are contrary to the evidence and are not supported by same.

(10) That the Board erred in that there are no findings of fact in the memorandum opinion to sustain the Board's conclusion of law as set out in its opinion and decision.

(11) That the Board erred in that the conclusions of law set out in its opinion are contrary to and not in harmony with the Board's findings of fact.

(12) That the Board erred in that the opinion and decision of the Board based upon its findings of fact are contrary to law.

LAW AND ARGUMENT.

Neither the Dividends of \$55,000.00 on the Stock of Paris American Pharmacal Company nor the Interest in the sum of \$2,242.50 Received by Loy Ola Grafe and Reported by Her in Her Income Tax Return Constitutes Taxable Income to Petitioner.

The uncontradicted testimony offered on behalf of Petitioner, which was supported by books and documentary evidence, proved that the 55 shares of stock of the Paris American Pharmacal Company and the bonds in the sum of \$53,787.20 belonged to Loy Ola Grafe and consequently neither the dividends received on the stock, nor the interest received from the bonds constituted property of this Petitioner. Under these facts the Board of Tax Appeals ignored the only positive and affirmative evidence offered at the trial and based its conclusions on mere conjectures and assumptions.

Attention is directed to the fact that, on motion by counsel for the Respondent, witnesses, after being duly sworn, were excluded from the courtroom out of hearing of the proceedings, with instruction from the Board Member that they should not discuss their testimony in the case with one another or with anyone else and should remain convenient to the courthouse until they were called to testify. All witnesses except the Petitioner, Louis M. Grafe, retired from the courtroom [R. p. 29].

The questions here involved have to do with a question of fact, to wit: Was the Petitioner the owner of 55 shares of Paris American Pharmacal Company stock and the \$55,000.00 in dividends paid thereon in 1929, and

was the Petitioner the owner of bonds costing \$53,787.20, purchased during the months of December, 1928, January, February, March and April of 1929 and the interest earned thereon during 1929 of \$2,242.50? Petitioner contends that it was the separate property of his wife, who returned it as income and paid the tax due thereon. The Board in its opinion held that the transfers of stock were lacking in bona fides notwithstanding the uncontradicted testimony of the Petitioner and his wife, which shows that the transfers of the stock to the wife on January 17, 1929 were genuine and for a valuable consideration and that the dividends paid thereon were neither actually nor constructively received by this Petitioner, nor were the dividends or the interest upon the aforementioned bonds actually or constructively received by him.

Petitioner testified that the Paris American Pharmacal Company was incorporated July 31, 1928 with a capital stock of \$7,000.00; that the money used for starting this business was that of his wife's, obtained from the sale of a bungalow in St. Louis, Missouri, which was her separate property by reason of a gift from her parents, and which had been sold two years previous to the date of incorporation, together with money obtained from the pledging of insurance policies which had been assigned to her. Of the \$3,400.00 borrowed on the insurance policies and the \$5,000.00 which was left from the money which the Petitioner's wife received from the sale of her bungalow, \$7,000.00 was put into the Paris American Pharmacal Company at the date of organization [R. p. 30]. Petitioner's mother-in-law contributed additional financial support in the way of a note pledged as security for advertising. For business reasons the 70 shares of stock were

held in Petitioner's name until January 17, 1929, at which time the 70 shares were split up, 25 going to Petitioner's mother-in-law as security on the \$3,400.00 note which was pledged as indicated above, 30 shares to Petitioner's wife and 15 shares retained by Petitioner.

The reason for splitting up the stock on January 17, 1929 (25 shares going to Mrs. Lewis under certificate #2 and 30 shares going to Mrs. Grafe under certificate #3), was explained by the Petitioner as follows: Mrs. Lewis had not received her note back, which she had put up as security on the advertising in the fall of 1928. The 25 shares were issued to her for two reasons, first, as collateral for the \$3,400.00 note and second, because Mrs. Grafe wanted her to have the stock in case she died before her mother. It had been agreed originally at the time of the organization of the corporation that Mrs. Grafe was to receive 55 shares; but instead she received 30 shares and Mrs. Lewis 25 shares. Petitioner put absolutely nothing into the business except his services. The 25 shares that were issued to Mrs. Lewis were the property of Mrs. Grafe. The checks that were made out to Mrs. Lewis for the dividends, were endorsed by Mrs. Lewis and given to Mrs. Grafe the next day after the dividend payment [R. pp. 34, 35]. The premiums paid on the insurance policies taken out on Petitioner's life had been made out of funds owned by his wife.

Petitioner was cross-examined by counsel for the Respondent and was re-examined by the Member of the Board and his testimony did not vary [R. pp. 33, 40].

Mrs. Grafe testified that for the money she put into the business she received 55 shares of stock of the Paris American Pharmacal Company. That 25 of the above

55 shares were held by her mother because she had guaranteed some advertising accounts a few months after the business had started, but that she held the shares only about a year and then they were transferred back to Mrs. Grafe; that in 1929 she received dividends on the 55 shares of stock in the total sum of \$55,000.00; that the dividends on 30 shares were received direct and the dividends on 25 share were received through her mother, who at that time held the stock in her name; that all of the dividends received by Mrs. Grafe's mother were turned over to Mrs. Grafe. The stock certificates that were issued were delivered to Mrs. Grafe and she put them in her own separate safe deposit box [R. p. 42]. There was no variance in the testimony of Mrs. Grafe as to the facts. It corroborated in almost every detail the testimony of the Petitioner. The Respondent did not put any witnesses upon the stand but relied solely upon the cross-examination of Petitioner and the witnesses called to testify in his behalf.

The books show that the stock was held during 1929 as follows [R. p. 20]:

| Certif. No. | Issued to | Date | Transfer | | Transfer to Ctfs. |
|----------------|--------------------|---------|------------|---------------|-------------------------|
| | | | No. Shares | from Ctfs. | |
| 1 | Louis M. Grafe | 7-31-28 | 70 | | 2, 3 & 4 |
| 2 | Mrs. Ivy R. Lewis | 1-17-29 | 25 | 1 | |
| 3 | Mrs. Loy Ola Grafe | 1-17-29 | 30 | 1 | |
| 4 | Louis M. Grafe | 1-17-29 | 15 | 1 | |

The books further show dividends paid as follows [R. p. 21]:

| | | | |
|---------------------|------------|-----------------------------|------------------------------------|
| February 28, 1929, | | | |
| L. M. Grafe, | \$7,500.00 | | |
| February 28, 1929, | | | |
| Mrs. Ivy R. Lewis, | 12,500.00 | | |
| February 28, 1929, | | | |
| Mrs. Loy Ola Grafe, | 15,000.00 | | |
| Total | | <u> </u> | \$35,000.00 |
| March 15th, | | | <u><u> </u></u> |
| Mrs. Ivy R. Lewis, | 1,902.92 | | |
| March 15th, | | | |
| Mrs. Ivy R. Lewis, | 10,597.08 | | |
| Total | | <u> </u> | \$12,500.00 |
| March 18th, | | | |
| Mrs. Loy Ola Grafe, | 15,000.00 | | |
| March 18th, | | | |
| L. M. Grafe, | 7,500.00 | | |
| Total | | <u> </u> | 22,500.00 |
| | | | <u><u> </u></u> |
| | | | \$35,000.00 |

The dividend checks were delivered to the record-holders. The checks were endorsed and used to pay for bonds that had previously been purchased by Petitioner's wife. The dividends that were paid to Mrs. Lewis were endorsed over to Mrs. Grafe since she was the owner of the 25 shares of stock which were pledged to Mrs. Lewis as security for the advertising bill until the note was returned to her. The stock was held by Mrs. Lewis as security only [R. p. 32]. A list of the securities which was attached to the Revenue Agent's report [R. pp. 47-49] shows purchases from December 19, 1928 to April 18, 1929 of various and sundry bonds amounting to \$53,-

787.20. Petitioner testified that the securities shown upon the list belonged to his wife as did the interest received on said bonds [R. p. 33].

The foregoing book evidence corroborated by the uncontradicted testimony of the Petitioner and his wife should not be disregarded. It should be accepted in the absence of some affirmative evidence to show that they are incorrect in determining the ownership of the stock here in question. If the book evidence is accepted it is obvious that the dividends paid upon the 55 shares of stock to Mrs. Grafe and Mrs. Lewis during 1929 were not income of this Petitioner.

The appeal before the Board involved only the year 1929. There is no occasion to go into the facts relative to the transfer of the Paris American Pharmacal Company business to the State of California in 1930 and the re-issuance of the stock in the Petitioner's name at that time.

The uncontradicted testimony of both Petitioner and his wife shows that the transfers of stock on January 17, 1929 to the wife and mother-in-law were genuine and were for the money put into the business by his wife; that the dividends paid thereon were actually paid to the record-holders of the stock; that the bonds that were purchased from December of 1928 to April of 1929 were paid for by the dividends that were received by Petitioner's wife, and that she kept her securities in a separate safe deposit box from that of her husband. The Board may not arbitrarily discredit the testimony of an unimpeached taxpayer as long as he testifies to facts. When the evidence before the Board, as the trier of the facts, ought to be convincing, it may not say that it is not. *Blackmer v.*

Commissioner, 70 Fed. (2d) 255. The issue under appeal in the *Blackmer* case was whether the taxpayer, an actor, made expenditures which were deductible as ordinary and necessary expenses of his trade or business. He was paid a salary and in one case a percentage of the gross receipts. Expenditures sought to be allowed as deductible from gross income were incurred for complimentary theater tickets, luncheons, suppers and entertainments, etc., given by the taxpayer. He kept no memorandum or book of accounts showing any of these expenses, except bills or statements rendered to him. The testimony of the taxpayer as to the necessity of the expenditures for entertainment and theater tickets was uncontradicted. The court reversed the order of the Board in the following language:

“In the instant case, the petitioner in his testimony named the persons, places, and events and stated in each instance the benefit he expected to obtain in a business way from entertaining the persons mentioned. The testimony made clear that the purpose of the entertainment was to enhance his reputation as an actor and to secure theatrical engagements more easily. His entertainment was reasonably connected with his profession. It tended to promote his popularity and thereby to increase his income from that business. The expenses were therefore ordinary and necessary expenses. Although the sums were substantial, the Board should not have refused the deduction. It is said that the amount was not established with absolute certainty. But the deduction should have been allowed, since it appears in the record that the amount claimed was reasonable under all the circumstances. Not only was all of it expended for business purposes, but, as the taxpayer testified, even a larger sum was. *Cohan v. Comm’r.*, 39 F. (2d)

540 (C. C. A. 2). *When the evidence before the Board, as the trier of the facts, ought to be convincing, it may not say that it is not.* Sioux City Stockyard Co. v. Comm'r., 59 F. (2d) 944 (C. C. A. 8); Conrad & Co. v. Comm'r., 50 F. (2d) 576 (C. C. A. 1); Chicago Ry. Equipment Co. v. Blair, 20 F. (2d) 10 (C. C. A. 7). *And the Board may not arbitrarily discredit the testimony of an unimpeached taxpayer so far as he testifies to facts. A disregard of such testimony is sufficient for our holding that the taxpayer has sustained the burden of establishing his right to a reduction and error has been committed in a contrary ruling.* Boggs & Buhl v. Comm'r., 34 F. (2d) 859 (C. C. A. 3)." (Italics ours.)

In the appeal of *Sioux City Stockyards Company v. Commission (supra)*, the 8th Circuit Court had under review the question of valuation of property rights. The court in its opinion held that the Board of Tax Appeals is a fact-finding body with the duty of arriving at some reasonable conclusion where it has before it substantial, uncontradicted evidence. The court's opinion on this point is as follows:

"The Board of Tax Appeals is a fact-finding body, and as such it was its duty to arrive at some reasonable conclusion, where it has before it substantial evidence which is uncontradicted. As said by Judge Page in *Chicago Railway Equipment Co. v. Blair* (C. C. A.), 20 F. (2d) 10, 12: 'Of course, every trier of fact should decide cases upon a conviction reached from a consideration of the evidence, and clearly evidence that produces such conviction must be satisfactory and convincing; but it is a well-known rule of law that triers of fact must be satisfied and convinced, if the evidence adduced, fairly considered,

preponderates for or against a given proposition. When the evidence before a trier of fact ought to be convincing, he may not say that it is not. Whether he is a judge or a commissioner, the facts must be fairly and judicially weighed, and a determination reached thereon.’ ”

Tax problems are practical problems. Realities and not presumptions should be taken into consideration in determining a taxpayer's liability to his government. Inasmuch as two witnesses (Petitioner and his wife) testified as to the bona fides of the transfer of the 55 shares of stock and the purchase of bonds in the sum of \$53,-787.20, which testimony is supported by the books and records and was uncontradicted, it is submitted that such testimony must be accepted in determining the issue in this case.

The case of *Bonwit Teller & Co. v. Commissioner of Internal Revenue*, 53 F. (2d) 381, cites the case of *Boggs & Buhl v. Commissioner*, 34 F. (2) 589 (C. C. A. 3), wherein the court said at page 861:

“* * * While the board may, as a general principle, reject expert testimony and reach a conclusion in accordance with its own knowledge, experience, and judgment, yet it must have knowledge of and experience with the particular subject under consideration. There is no evidence that the board had any independent and personal knowledge whatever of the business, reputation, and good will of the petitioner. Therefore it could not set aside or disregard all the positive and affirmative evidence as to the value of the good will, and base its conclusion upon

conjecture. *Midland Valley R. R. Co. v. Fulgham* (C. C. A.), 181 F. 91, 95; *De Ford v. Commissioner* (C. C. A.), 29 F. (2d) 532. Consequently it should not have disregarded the only positive and direct evidence as to the value of the good will of the petitioner. * * *

In the case of *Redfield v. Eaton*, 53 F. (2d) 693, the court said at page 696:

“* * * No one doubts that his decision” (the Commissioner’s) “is sufficient basis for the additional assessment and levy; thus casting on a plaintiff, who brings the controversy into court, the burden of proof upon all material allegations of the complaint. But that the Commissioner’s decision, resting on evidence not presented to the court—in this case the defendant offered not a single witness—has the quality of probative evidence in determining the preponderance of evidence, is a proposition supported neither by authority nor reason.”

The Board in its opinion [R. p. 16] after reviewing the reasons for the transfer of the stock to the Petitioner in 1930 when the corporation was moved to California, stated that “we feel that the Petitioner here has failed to meet the burden upon him to overcome the presumption of the correctness of the Respondent’s determination.” After reciting the fact that the Petitioner, his wife and mother-in-law bore confidential relationships to each other, the Board concludes with the statement:

“Despite the statements of the parties to the transaction that the transfers of the stock were genuine and for valuable consideration, the record quite conclusively shows that they were lacking in bona fides.

“The petitioner having failed to overcome the presumption of the correctness of the Respondent’s determination—

“Decision will be entered for the respondent.”

Just because there is a confidential relationship between parties certainly is no reason for disregarding book and documentary evidence and uncontradicted and undisputed testimony as to actual facts. If the Board draws inferences not warranted by the facts found or makes erroneous application of law, its decisions are open to review and may be reversed or modified by the court or remanded for that purpose. 26 U. S. C. A., 641 (1935 Ed.) There must be more than a mere suspicion that a perfectly legitimate transaction by men of high, unquestioned integrity was made for the sole purpose of committing a fraud by reducing taxes.

In the cases cited and relied upon by the Board in its opinion [R. p. 16], the facts are not comparable. In all of these cases the *mala fides* is apparent, while in the case at bar there is no lack of evidence showing the *bona fides* of the transactions here under review. There was a good, valid, and sufficient consideration given for the stock by Petitioner’s wife. In fact, the money used to organize the Paris American Pharmacal Company was her separate property. If we are to deal in presumptions, disregarding the testimony of the three witnesses, the fact that the books show the 55 shares were not in Petitioner’s name during 1929 when the dividends were paid on the stock, we must presume that the stock was not his, nor were the dividends paid thereon his.

In the case of *Budd v. Commissioner*, 12 B. T. A. 490, the Board was reversed by the Circuit Court of Appeals (3d), 43 Fed. (2d) 509. The petitioner in that case purchased 7,500 shares of stock of the Budd Wheel Company for \$100.00 per share. He later sold 3,000 shares of the same stock at \$70.00 per share to Mr. Read who had given his note for \$210,000.00 as payment for said stock. At that time Read was worth \$600,000. Subsequently, Read sold 660 shares of the stock to a third party and gave petitioner a check for the amount realized from the sale of said 660 shares. About fifteen months later Read sold the balance of the stock back to petitioner, who in turn cancelled the note. The Board held that the sale was not bona fide and therefore refused to allow the petitioner the loss as a deduction on his return. On appeal the Circuit Court reversed the Board. The opinion of the court reads in part as follows at page 512:

“* * * We think that the inference drawn of mala fides from undisputed facts is unreasonable and unsupported by any substantial evidence. There must be something more than mere suspicion that a perfectly legitimate transaction by men of high and unquestioned integrity was made for the sole purpose of committing a fraud by reducing taxes on account of a loss suffered in the depreciation of stock. ‘If the device is carried out by means of legal forms, it is subject to no legal censure.’ *United States v. Isham*, 84 U. S. (17 Wall.) 496, 21 L. Ed. 728.

“This, however, leaves still standing upon the petitioner the burden of proof of showing the Commis-

sioner's determination, which is presumptively correct, to be erroneous.

“In plain terms the position of the Commissioner is that Mr. Budd and Mr. Read are guilty of an attempt to commit a deliberate fraud. It is a general principle that fraud is never to be presumed, and he who avers it, takes upon himself the burden of proving it. *Addleman v. Manufacturers' Light & Heat Co.*, 242 Pa. 587, 590, 89 A. 674; *Maguire v. Preferred Realty Co.*, 257 Pa. 48, 52, 101 A. 100; *In re Kayser (C. C. A.)* 177 F. 383, 386. The determination of the Commissioner being presumptively correct, in appealing from the additional assessment, Mr. Budd was required to prove a sale, transfer of title, a valuable consideration, and the other positive elements upon which he relied. This he did, and this must stand unless the sale was a pretense and a fraud. That it was is in substance what the Commissioner charges. It is necessary for him to bear the burden of establishing this by clear proof. *Bamberger v. Schoolfield*, 160 U. S. 149, 16 S. Ct. 225, 40 L. Ed. 374; *Lalone v. United States*, 164 U. S. 255, 17 S. Ct. 74, 41 L. Ed. 425, unless the well-established rule of law generally applicable is different in tax cases, and the Commissioner says it is. The Commissioner made no attempt to prove fraud, but relied upon Mr. Budd to negative the charge of fraud. But fraud cannot be inferred by the court or jury from acts, legal in themselves and consistent with an honest purpose. *Foster v. McAlester et al. (C. C. A.)*, 114 F. 145, 152.”

Petitioner recognizes that he had the burden of overcoming by competent proof the presumption established by the Respondent's determination. Petitioner assumed this burden and the evidence, it is respectfully submitted, shows that that presumption has been overcome. This evidence shows that the stocks and the bonds were the property of Loy Ola Grafe and not the property of Petitioner and also shows that the dividends received on the stock and the interest received from the bonds were likewise the property of Loy Ola Grafe and not the property of Petitioner. Fraud was not in issue before the Board and if the Respondent relied upon mala fides or fraud in the support of his determination the burden of proof was placed upon him. (Section 907 (a), Revenue Act of 1926, as amended.) The Respondent made no attempt to prove fraud. As indicated in the *Budd* case, *supra*, fraud cannot be inferred by the court or jury from acts, legal in themselves and consistent with an honest purpose.

Conclusion.

The record conclusively establishes, it is respectfully submitted, that the Board erred in failing to find that the money with which the Paris American Pharmacal Company was organized and started business belonged to and was the separate property of Petitioner's wife and that the 55 shares of stock issued to Petitioner's wife and his mother-in-law on January 17, 1929 were in fact payment for the money thus advanced for organizing and starting said business and were the separate property of Petitioner's wife; therefore the dividends paid on the 55 shares were not income to this Petitioner, nor was the interest received on the bonds in question.

In view of the foregoing it is respectfully urged that the decision of the Board is contrary to the facts found by it; that the Board's opinion is contrary to the law and evidence, and that the Board did not make any findings of fact that support its conclusion, and should be reversed.

Respectfully submitted,

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